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LOBBYING AND POLITICAL ACTIVITIES OF TAX-EXEMPT ORGANIZATIONS

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INTRODUCTION AND OVERVIEW

The Subcommittee on Oversight of the House Committee on Ways and Means has scheduled public hearings on March 12 and 13, 1987, to review the Federal tax rules applicable to the lobbying and political activities of tax-exempt organizations. This pamphlet[1] provides a description of those rules under present law.

Rules for Lobbying and Political Activities of Different Types of Tax-Exempt Organizations (Part I)

Present law provides twenty-five different categories of organizations which generally are exempt from Federal income tax.[2] Part I of this pamphlet describes the rules governing the amount of lobbying and political activity of such organizations, without attempting to define what activities are treated as lobbying or political activities.

Rules relating to charitable, religious, scientific, etc. organizations.—Present law generally provides that a charitable organization for which deductions are allowed for Federal income tax purposes[3] cannot engage in any political activity and cannot engage in more than an insignificant amount of lobbying activity. Present law also provides rules under which certain organizations described in section 501(c)(3), other than private foundations, can elect to have the determination of the amounts that can be expended for lobbying purposes made under an objective formula (sec. 501(h)). Further, present law provides special rules restricting lobbying and political activity by private foundations.

Other exempt organizations.—In the case of exempt organizations for which charitable deductions for contributions are not allowed for Federal income tax purposes, the rules are much less restrictive. In some cases, both lobbying and political activities are allowed so long as those activities are not the principal activity of the organization.

Business deductions for expenditures for lobbying or political activity.—Present law generally disallows business deductions for amounts spent for political activity and limits deductions for lobbying to expenditures for communications directly with a legislature regarding legislation that directly affects the taxpayer (sec. 162(e)).

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[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Lobbying and Political Activities of Tax-Exempt Organizations* (JCS–5–87), March 11, 1987.

[2] While such organizations generally are exempt from Federal income tax on investment income and income derived from activities engaged in as part of its exempt purposes, such organizations are subject, nonetheless, to Federal income tax on any income from unrelated business activities. (See Code secs. 511–514).

[3] Charitable deductions for contributions to exempt organizations generally are allowed for Federal income tax purposes only for contributions to organizations organized and operated exclusively for charitable, educational, religious, etc. purposes (sec. 501(c)(3)), contributions to fraternal organizations (sec. 501(c)(10)) where such contributions are used exclusively for religious, charitable, scientific, etc. purposes, and contributions to veterans' organizations (sec. 501(c)(19)).

Thus, these rules generally are consistent with the rules which allow charitable deductions for amounts contributed to exempt organizations that cannot engage in any political activities and which restrict the amount of lobbying in which such tax-exempt organizations can engage.

Political organizations.—Present law provides special rules for organizations (including political committees and political action committees) which are formed and operated primarily for political purposes (sec. 527.) In general, these rules provide that these organizations are exempt from tax on income from contributions, member dues, fundraisers, etc., but are subject to tax on their investment income.

Definition of political activity (Part II)

Part II of this pamphlet provides a more detailed description of what types of activities are considered political activities. This description includes a discussion of the difference between political and educational activity (including a discussion of the rules applicable to voter registration drives), who is a considered a candidate, and which activities are treated as intervention in a political campaign.

Generally, the same types of activities are treated as political activities for purposes of the various rules governing exempt organizations. However, since there is no uniform definition of political activity provided by the Internal Revenue Code, separate rules have evolved in different areas where the issue is relevant.

Definition of Lobbying (Part III)

Part III of this pamphlet provides a more detailed description of activities which are treated as lobbying activities under present law.[4] This description includes a discussion of what is treated as legislation, what activities are treated as lobbying (including exceptions for nonpartisan analysis and advice), the differences between direct lobbying and grassroots lobbying, attribution of activities of members to organizations, and allocation of expenditures between lobbying activities and other activities.

The Internal Revenue Code does not provide a single definition of lobbying for all of the provisions where the issue of lobbying is relevant. As a result, separate rules are provided, or have evolved, in one area that do not apply in another area.

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[4] Since the hearing will not address the proposed regulations issued under sections 501(h) and 4911 by the Internal Revenue Service on November 5, 1986, this pamphlet does not include a description or a discussion of those proposed regulations.

I. RULES FOR LOBBYING AND POLITICAL ACTIVITIES BY DIFFERENT TYPES OF TAX-EXEMPT ORGANIZATIONS

A. Charitable, Religious, Scientific, Etc. Organizations (Sec. 501(c)(3) Organizations)

Code section 501(c)(3) provides that an organization may be exempt from Federal income tax (and can receive charitable contributions that are deductible by donors)[5] if, among other requirements, it is "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes."[6] Typical examples of section 501(c)(3) organizations include nonprofit universities, hospitals, scientific journals, churches, and groups engaged in aid to the poor.[7]

An organization cannot qualify under section 501(c)(3) unless "no substantial part of [its] activities . . . is carrying on propaganda, or otherwise attempting, to influence legislation, . . . and [the organization] does not participate in, or intervene in (including the publishing or distributing of statements) any political campaign on behalf of any candidate for public office."

The rule that section 501(c)(3) organizations cannot engage in substantial lobbying activities has been in the Internal Revenue Code since 1934. Such organizations have been forbidden to engage in any political campaign activity since 1954.

1. General rule for section 501(c)(3) organizations

Since section 501(c)(3) organizations are not allowed to engage in any political campaign activities, the principal issue presented by the ban is, simply, the definition of such an activity.[8] With respect to lobbying activities, however, a second issue exists. Lobbying activities lead to denial of tax-exempt status under section 501(c)(3) only if they are substantial in relation to the organization's other activities. Thus, it is necessary not only to determine the definition of such an activity,[9] but also to determine the definition of the term "substantial."

The statute does not explain the meaning, in this context, of the term "substantial." There is no precise mechanical rule for determining the substantiality of an organization's lobbying activities in relation to its other activities. In particular, an arithmetical percentage test (e.g., looking at the percentage of the budget, or of em-

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[5] Section 170(a).

[6] An organization also can qualify under section 501(c)(3) if it is organized and operated exclusively to foster national or international sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals.

[7] An organization cannot qualify under section 501(c)(3) unless no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

[8] This issue is discussed in Part II of this pamphlet.

[9] This issue is discussed in Part III of this pamphlet.

ployees' time, spent on lobbying), while relevant, has been held not determinative.[10]

To the extent that such a test is relevant, the percentage of the organization's expenditures or time that can relate to lobbying without endangering the exemption may be relatively small. For example, while an organization that spent less than 5 percent of its time on lobbying activities was held not to be substantially involved therein,[11] the fact that another organization spent about 20 percent of its budget on lobbying activities contributed significantly to the court's finding of substantial involvement.[12]

The reason for not looking solely at the percentage of time or money spent by an organization on lobbying is that such a focus "obscures the complexity of balancing the organization's activities in relation to its objectives and circumstances."[13] For example, an organization's budget may give an incomplete picture to the extent that it does not reflect the volunteer time and publicity devoted to lobbying activities by the organization, and the continuous or intermittent nature of the organization's involvement in the activities.[14]

In addition, even aside from weighing efforts not reflected in the budget that are devoted to lobbying, substantiality can be found because of the nature of the organization and its aims. Longstanding Treasury regulations state that an organization will be treated as an "action" organization (i.e., one not qualifying under section 501(c)(3) by reason of its involvement in lobbying) if its main or primary objective or objectives can be accomplished only by legislation or by the defeat of proposed legislation.[15] For example, an organization that studied disparities in the Federal and State tax treatment of different types of business organization, with the aim of achieving tax revisions that would remove the disparities, was held to be engaged in lobbying.[16]

2. Effect of making an election under section 501(h)

The absence of precise rules for determining when an organization's lobbying activities are "substantial" can give rise to uncertainty regarding the application of section 501(c)(3). An organization that wishes to engage in lobbying without losing its exempt status may have difficulty in determining exactly how much lobbying it can engage in.

The vagueness of the substantiality standard also was viewed as impeding the Internal Revenue Service in its efforts to enforce the requirements of section 501(c)(3) in a neutral and effective

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[10] *See Seasongood* v. *Comm'r*, 227 F.2d 907 (6th Cir. 1955), (where less than 5 percent of an organization's time and effort were spent on lobbying activities, such activities were not substantial in relation to the organization's other activities); *Haswell* v. *United States*, 500 F.2d 1133 (Ct. Cl. 1974), *cert. denied*, 419 U.S. 1107 (1975) (the fact that an organization spent between 16.6 percent and 20.5 percent of its budget on lobbying provided a strong indication of substantiality).

[11] *Seasongood, supra.* This case subsequently has been questioned on this issue. *See Christian Echoes National Ministry, Inc.* v. *United States*, 470 F.2d 849 (10th Cir. 1972), *cert. denied*, 414 U.S. 864 (1973).

[12] *Haswell, supra.*

[13] *Christian Echoes National Ministry, supra.*

[14] G.C.M. 36148 (January 28, 1975).

[15] Treas. Reg. sec. 1.501(c)(3)-1(c)(3)(iv).

[16] *Roberts Dairy Co.* v. *Comm'r*, 195 F.2d 948 (8th Cir. 1952), *cert. denied*, 344 U.S. 865 (1952). *See also* Revenue Ruling 62-71, 1962-1 C.B. 85 (organization that adopted a doctrine or theory that could become effective only upon enactment found to be an action organization).

manner.[17] Without a precise means of determining which organizations were lobbying excessively, it was difficult to determine how enforcement efforts should be allocated. Moreover, the lack of any intermediate penalty for excessive lobbying, short of denying the exemption, meant that slight differences in the amount of lobbying conducted could lead to major differences in tax treatment (i.e., revocation of tax-exempt status).

In 1976, Congress responded to these issues by enacting section 501(h). Under this provision, certain organizations seeking to qualify under section 501(c)(3) can elect to have the amount of lobbying in which they may engage measured under a precise arithmetical test, rather than just the general "substantiality" standard. Exemption under section 501(c)(3) may be denied to an electing organization where its lobbying activities exceed the arithmetical limit set forth in section 501(h). A lesser level of excessive lobbying expenditure by an organization electing the application of section 501(h) gives rise to a penalty excise tax under section 4911, but not to revocation of the underlying tax exemption. Separate limits are provided for direct lobbying and grass roots lobbying.

The following types of section 501(c)(3) organizations cannot elect the application of section 501(h): (a) churches (along with conventions or associations of churches, and certain organizations auxiliary to, or associated with, churches);[18] (b) certain organizations whose purpose involves supporting organizations exempt under section 501(c) (4), (5), or (6);[19] (c) organizations engaged in testing for public safety;[20] and (d) private foundations.[21]

Section 4911 defines the amount of lobbying in which an organization electing the application of section 501(h) can engage without any penalty whatever. This amount (referred to as the "lobbying nontaxable amount") varies with the amount of exempt purpose expenditures incurred by the organization during the taxable year.[22] The lobbying nontaxable amount for direct lobbying equals 20 percent of the first $500,000 of exempt purpose expenditures, plus 15 percent of the second $500,000, plus 10 percent of the third $500,000, plus 5 percent of any additional exempt purpose expenditures. However, in no event can the lobbying nontaxable amount exceed $1 million.

Section 4911 also contains a limit on grass roots expenditures applying to organizations that elect the applicability of section 501(h). Grass roots expenditures are defined as lobbying expenditures that are directed at influencing public opinion, rather than at influencing legislative bodies, their employees, or other government officials. Under section 4911, the amount of grass roots expenditures that an organization can incur without penalty (referred to as the

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[17] *See* Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, 1976-3 C.B. (Vol. 2) (henceforth, "General Explanation of 1976 Act") at 419-20.

[18] *See* sections 170(b)(1)(A)(i), 508(c), 6033, and 4911(f)(2). Churches were made ineligible for the section 501(h) election at their own request. *See* General Explanation of 1976 Act, at 427.

[19] *See* section 509(a)(3).

[20] *See* section 509(a)(4).

[21] *See* section 509. Special rules applying to private foundations are described below.

[22] For purposes of section 4911, exempt purpose expenditures are defined as expenditures to accomplish the organization's exempt purposes, including properly allocable salary payments, overhead, and all lobbying expenditures (whether or not related to an exempt purpose).

"grass roots nontaxable amount") is 25 percent of the amount of lobbying expenditures that can be incurred without penalty.

Whenever an organization's expenditures for a taxable year exceed the lobbying nontaxable amount, or the grass roots nontaxable amount, a penalty tax under section 4911 is imposed. This tax is equal to 25 percent of the amount of the excess lobbying expenditures (i.e., the excess overall lobbying or the excess grass roots lobbying, whichever excess is greater in comparison to the applicable limitation).

For example, assume that in a particular taxable year an organization has exempt purpose expenditures of $2 million. The lobbying nontaxable amount equals $250,000, and the grass roots nontaxable amount is $62,500. The organization's lobbying expenditures for the year total $330,000, of which $130,000 are grass roots expenditures. The taxpayer's expenditures exceed the lobbying nontaxable amount by $80,000 ($330,000 minus $250,000), and exceed the grass roots nontaxable amount by $67,500 ($130,000 minus $62,500). The greater of these two numbers, or $80,000, is subject to the penalty tax. Accordingly, in this case, the amount of penalty tax imposed would be $20,000.

Excess lobbying or grass roots expenditures, in addition to giving rise to the penalty tax under section 4911, can under some circumstances lead ultimately to the denial of an organization's exemption under section 501(c)(3). Section 501(h) establishes ceiling amounts on lobbying and grass roots expenditures, equal to 150 percent of the nontaxable amounts.[23] An organization's exemption is denied if its lobbying or grass roots expenditures normally exceed the applicable ceiling amount (i.e., are at least 150 percent of the nontaxable amount).

There is no rule preventing an organization that loses its exemption because it normally exceeds either of the section 501(h) ceilings from applying for restoration of the exemption in a subsequent taxable year. However, when an organization loses its exemption under section 501(c)(3) by reason of lobbying (either under the general substantiality test or through the application of section 501(h)), the organization cannot thereafter be treated as an exempt organization by reason of section 501(c)(4) (relating to civic organizations, social welfare leagues, etc.).[24] The Treasury Department has regulatory authority to prescribe rules for preventing the evasion of this rule through the use of devices such as the transfer of an organization's assets to another organization.

3. Special rules for private foundations

In 1969, Congress enacted additional rules relating to political and lobbying expenditures by section 501(c)(3) organizations that are private foundations. Private foundations are defined under section 509 as all organizations described in section 501(c)(3) other than those expressly excepted, generally by reason either of being

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[23] Thus, in the above example, where the lobbying nontaxable amount was $250,000, the lobbying ceiling amount is $375,000. Since the grass roots nontaxable amount was $62,500, the grass roots ceiling amount is $93,750.

[24] Section 504.

a specific type of organization, or of receiving broad-based financial support from the general public.

An organization is not treated as a private foundation, without regard to its sources of financial support, if it qualifies, under the applicable definitions, as one of the following: a church, an educational institution, a hospital or certain medical care or research organization, a foundation providing specified types of assistance to certain universities or colleges that are exempt from tax, or a governmental unit.[25]

In addition, an organization generally is not a private foundation if it normally receives a substantial part of its support from governmental units or direct or indirect contributions from the general public.[26] For this purpose, membership or attendance fees paid by members of the general public for services related to the organization's exempt function are treated as contributions.[27]

An organization that constitutes a private foundation is subject to a regulatory excise tax under section 4945 with respect to political and lobbying expenditures. The initial tax imposed equals 10 percent of the amount of such expenditures. In addition, each manager of the foundation who knowingly participates in the expenditure is taxed at a rate of 2.5 percent (up to a maximum of $5,000).

If the expenditure is not corrected by the time that the Internal Revenue Service mails a deficiency notice with respect to the penalty tax (or such tax is assessed, if that occurs first), then additional penalty taxes are imposed. For the foundation, the additional tax equals 100 percent of the amount expended. For a manager who refuses to agree to corrective action, the additional tax is 50 percent of the amount expended (up to a maximum of $10,000).

A final sanction may apply if the foundation continues not to correct its political or lobbying expenditures. Under section 507, willful repeated or willful and flagrant violations of the private foundation rules can lead to termination of private foundation status. The terminated organization can be required to pay to the Federal Government the value (with interest) of all tax benefits received (by the organization or charitable contributors thereto) by reason of the organization's former status under section 501(c)(3). This penalty tax may be abated to the extent that the organization contributes its assets to section 501(c)(3) organizations that are not private foundations.

4. Consequences of lobbying for tax treatment of donors

A final issue raised by lobbying activities of a section 501(c)(3) organization relates to the tax treatment of donors. In general, the fact that a section 501(c)(3) organization has engaged in lobbying, but only to an extent consistent with remaining exempt under the provision, has no effect on the charitable deductions of taxpayers

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[25] *See* sections 509(a)(1) and 170(b)(1)(a)(i) through (vi).

[26] Section 509(a)(2). However, such an organization may nonetheless be treated as a private foundation if two-third or more of the organization's support for a taxable year normally consists of unrelated business taxable income (net of the tax imposed on such income by section 511) or gross investment income.

[27] An organization also may avoid treatment as a private foundation if it exists to support another section 501(c)(3) organization that is not a private foundation, subject to certain additional requirements relating to operation and control of such support organization. Section 509(a)(3).

making contributions to the organization. However, contributions to the organization that are specifically earmarked for lobbying are not allowable as charitable deductions.[28]

When a taxpayer makes a contribution any part of which is deductible as a charitable contribution, no part of the contribution is deductible as a business expense.[29] Thus, a contribution that was partially earmarked for lobbying would not give rise to a business deduction with respect to the part not allowable as a charitable deduction. In the case of a contribution wholly earmarked for lobbying, other limitations on business deductions for lobbying would apply. In general, such expenses are deductible only if incurred in the course of a trade or business, with regard to a matter of direct interest to the taxpayer, and are not allowable with respect to grass roots lobbying."[30]

B. Other Types of Exempt Organizations

In general

A number of other organizations that are described in section 501(c), and that accordingly are exempt from tax, are subject to special rules to the extent that they engage in political or lobbying activities. The types of organizations most relevant in this regard are social welfare organizations (sec. 501(c)(4)), labor unions (along with agricultural and horticultural organizations) (sec. 501(c)(5)), trade associations (sec. 501(c)(6)), and veterans' organizations (sec. 501(c)(19)).

In general, these organizations are subject to less stringent restraints on conducting political and lobbying activities than are section 501(c)(3) organizations. These lesser restrictions reflect the fact that the above organizations—with the exception of veteran's organizations—are not benefited by the tax law to the same extent as section 501(c)(3) organizations.

The above organizations, like section 501(c)(3) organizations, generally are exempt from tax with respect to the performance of activities related to their exempt functions. However, in the case of social welfare organizations, labor unions, and trade associations, contributions made by taxpayers are not deductible as charitable contributions. (Membership contributions to such organizations may, however, be deductible as ordinary and necessary business expenses, except to the extent attributable to political activity or grass roots lobbying.)

By contrast, contributions to veterans' organizations, like contributions to section 501(c)(3) organizations, can give rise to charitable deductions. Thus, veterans' organizations benefit, in relation to section 501(c)(3) organizations, from more liberal standards regarding

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[28] *See* Treas. Reg. sec. 1.170A-1(h)(6). Since section 501(c)(3) organizations cannot engage in political activity, a contribution earmarked for political use likewise would not be allowable as a charitable deduction.

[29] *See* Section 162(b); Treas. Reg. sec. 1.162-15(a).

[30] Section 162(e). These rules are described more fully below, in B. "Other Types of Exempt Organizations."

political activity and lobbying, without being less favored by the tax law with respect to taxpayer contributions.[31]

Social welfare organizations

Section 501(c)(4) provides a tax exemption for "[c]ivic leagues and organizations not organized for profit but operated exclusively for the promotion of social welfare." In addition, the provision applies to "local associations of employees . . . the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes."

Section 501(c)(4) organizations resemble section 501(c)(3) organizations in several respects. This resemblance results, not only from the parallel requirements of not being conducted for profit, but also from the similarity between promoting social welfare (section 501(c)(4)) and serving charitable purposes (section 501(c)(3)).

Two of the principal differences between the two provisions include, first, the fact that contributions to social welfare organizations are not deductible as charitable contributions, and, second, the fact that an organization is not disqualified under section 501(c)(4) by reason of being an "action organization" (i.e., one not qualifying under section 501(c)(3) by reason of its political or lobbying activities).

Social welfare organizations can qualify under section 501(c)(4) even if their activities consist in substantial part of political or lobbying activities. However, the exempt purpose of promoting social welfare does not include engaging in political activity (i.e., participating directly or indirectly in political campaigns on behalf of or in opposition to any candidate for public office).[32] Thus, if political activity is the organization's primary purpose, the organization is not exempt under section 501(c)(4), which requires that the promotion of social welfare be the organization's primary purpose.

Since political activity is defined as not a part of promoting social welfare, an organization whose primary purpose is political cannot be exempted under section 501(c)(4) even if its political activities bear some subject matter relationship to its social welfare goals. For example, assume that an organization seeks to promote environmental protection, and that this goal involves the promotion of social welfare. If the organization's primary means of pursuing this goal is supporting candidates for public office who support governmental programs to provide environmental protection, then the organization is not exempt under section 501(c)(4).

Different rules apply with regard to lobbying by social welfare organizations. Under appropriate factual circumstances, lobbying activities can be treated as relevant to the promotion of social welfare. Thus, an organization with social welfare goals can seek to advance those goals principally through lobbying, consistently with being exempt under section 501(c)(4). For example, if the organization described above sought to promote environmental protection principally by contacting Members of Congress to urge such Mem-

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[31] In *Regan* v. *Taxation With Representation of Washington*, 461 U.S. 540 (1983), the Supreme Court held that it was not unconstitutional to permit veteran's organizations, consistent with retaining their exempt status, to engage in lobbying that would lead to denial of exemption if engaged in by a section 501(c)(3) organization.

[32] *See* Treas. Reg. sec. 1.501(c)(4)–2.

bers to vote in favor of environmental legislation, such organization still could qualify as exempt under section 501(c)(4).

Labor, agricultural, and horticultural organizations

Section 501(c)(5) provides a tax exemption for "[l]abor, agricultural, or horticultural organizations." Such an organization is not exempt, however, unless no net earnings inure to the benefit of any member, and the organization's aim is to improve the occupations to which it relates, with regard to working conditions, product quality, or general efficiency.[33] The provision exempts from tax organizations such as labor unions engaged in collective bargaining, and organizations that seek to improve the science of agriculture.

A section 501(c)(5) organization, like a social welfare organization, can engage in lobbying relating to its exempt purpose without endangering its exemption. The Internal Revenue Service has stated that political activities of section 501(c)(5) organizations are subject to the same limitation as such activities by social welfare organizations (i.e., such activities cannot be the primary means of accomplishing its exempt purposes).

Business leagues (trade associations)

Section 501(c)(6) provides a tax exemption for "[b]usiness leagues, chambers of commerce, real estate boards, boards of trade, or professional football leagues . . . not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual."

The exemption does not apply to organizations engaged in a regular business that ordinarily would be conducted for profit, or that provides information for the private benefit of individuals (e.g., furnishing investment advice). Rather, the exemption applies to organizations whose activities are directed to the improvement of business conditions in one or more lines of business.[34] The rules for political and lobbying activities by trade associations and other organizations exempt under section 501(c)(6) are the same as those for organizations exempt under paragraphs (4) and (5) of section 501(c).

Veterans' organizations

Section 501(c)(19) provides a tax exemption for veterans' organizations. In order for an organization to qualify for the exemption, at least 75 percent of its members must be past or present members of the United States Armed Forces, and substantially all other members must be cadets, or spouses, widowers, or widows of past or present members of the Armed Forces. Additionally, in order to qualify for exemption, none of the organization's net earnings can inure to the benefit of any private shareholders or individuals, and the organization must serve exempt purposes (such as benefiting the community or war veterans, or providing social or recreational activities for organization members).[35]

Contributions to veterans' organizations, unlike contributions to organizations described under paragraphs (4), (5), or (6) of section

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[33] Treas. Reg. sec. 1.501(c)(5)-1.
[34] Treas. Reg. sec. 1.501(c)(6)-1.
[35] Section 501(c)(19); Treas. Reg. sec. 1.501(c)(19)-1.

501(c), are deductible as charitable contributions.[36] The rules for political and lobbying activities by veterans' organizations are the same as those for organizations described under paragraphs (4), (5), or (6) of section 501(c).

C. Tax Consequences (Other Than Loss of Exemption) of Political and Lobbying Activities by Exempt Organizations Not Described in Section 501(c)(3)

While political and lobbying activities by section 501(c) organizations (other than those exempt under section 501(c)(3)) are allowable to the extent described above, such activities may have tax consequences (other than denial of the exemption) under certain circumstances. Such tax consequences can relate either to a taxpayer claiming a business deduction for dues or other payments to such an organization, or to the organization itself.

As noted above, while contributions to a section 501(c) (4), (5), or (6) organization are not allowable as charitable deductions, such contributions may give rise to business deductions where all generally applicable requirements for such deductions are met.[37] For example, the contribution must be an ordinary and necessary expense incurred in carrying on a trade or business (not, e.g., a personal expense that one elects to have one's business pay).[38]

Among the requirements applying to business deductions generally, and thus to business deductions for contributions (such as dues) to section 501(c) (4), (5), or (6) organizations, is one relating to expenses for political and lobbying activity. In general, a taxpayer can deduct certain expenses of lobbying, in the course of a trade or business, with respect to legislation or proposed legislation that is of direct interest to the taxpayer.[39] No business deduction is allowed, however, either for political activity or for grass roots lobbying (i.e., attempting to influence the general public, or a part thereof, with respect to legislative matters, elections, or referendums).[40]

Deductions for dues paid to organizations that engage in lobbying or political activities likewise are limited under these rules.[41] Longstanding regulations address the application of these rules in circumstances where a substantial part of the activities of an exempt organization consist of political activity or grass roots lobbying.[42] Under such circumstances, business deductions for dues or other payments to the organization are allowed only for such portion of the dues or other payments as the taxpayer can clearly establish are attributable to activities other than political activity or grass roots lobbying.[43]

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[36] Section 170(c)(3).

[37] *See* Treas. Reg. sec. 1.162-15(c).

[38] In practice, a contribution to a section 501(c)(4) organization may be less likely to give rise to a business deduction than a contribution, for example, to a labor union described by section 501(c)(5), or a trade association described by section 501(c)(6).

[39] Section 162(e)(1). The types of expenses that are deductible include expenses in connection with appearances before or other communications with committees or Members of Federal, State, and local legislative bodies, as well as expenses of communicating relevant information to members of organizations with direct interests in the legislation.

[40] Section 162(e)(2).

[41] Section 162(e)(1).

[42] Treas. Reg. sec. 1.162-20(c)(3).

[43] *Id.* The regulation also provides that lobbying expenses relating to matters of direct interest to the organization are treated, in effect, like lobbying expenses relating to matters of direct interest to the taxpayer.

The incurrence by a section 501(c) organization of expenses for political activities can have tax consequences even if the activities do not prevent the organization from qualifying as exempt under section 501(c). Specifically, tax liability can arise under section 527 (relating to political organizations), through the application of a rule designed to ensure that social welfare organizations will be treated similarly to political organizations with respect to political expenses.

Under section 527(f), an exempt organization is treated as having taxable income equal to whichever is the *lesser* of the following two amounts: its political expenditures[44] and its net investment income.[45] The amount so determined is subject to tax at the highest applicable corporate rate (34 percent for taxable years beginning after December 31, 1987). This provision promotes neutrality of treatment as between section 501(c) organizations that engage in political activities and section 527 political organizations because, as described in D., below, the latter organizations generally are taxed on net investment income.

As an example of this rule, assume that a section 501(c) organization has net investment income of $100,000 and spends $150,000 on political activities (i.e., exempt function expenditures for purposes of section 527). The income that is subject to tax at the highest corporate rate is $100,000. If the organization had spent only $80,000 on political activities, while still having net investment income of $100,000, then the income subject to tax would have been $80,000.

A section 501(c) organization can establish a separate segregated fund, receiving a separate allocable share of dues and keeping separate records, to engage in political activities. For purposes of section 527 (described more fully below), such fund is treated as a separate organization. Thus, the fund separately is subject to the general political organization rules of section 527, in lieu of taxing the organization as a whole under section 527.[46] The political activities of the fund are, however, relevant to determining whether the organization is exempt under section 501.

D. Political Organizations (Section 527)

In general, section 527 provides a tax exemption from Federal income tax for the income, other than investment income, of political organizations (e.g., political action committees). A political organization is defined as an organization that is organized and operated for the purpose of accepting contributions (directly or indirectly) or making expenditures, or both, for an exempt function.[47] For this purpose, an "exempt function" is defined as "influencing or attempting to influence the selection, nomination, election, or ap-

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[44] A political expenditure for this purpose is one that, if incurred by a section 527 political organization, would be treated as incurred for an exempt function, as defined by section 527(e)(2) (i.e., in "influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization . . ."). This definition may be broader than the definition of political activities generally applying for purposes of section 501(c).

[45] Net investment income is defined for this purpose as the excess of gross income from interest, dividends, rents, royalties, and net capital gains, over deductions directly connected with the production of such gross income.

[46] Section 527(f)(3).

[47] Section 527(e)(1).

pointment of any individual to any Federal, State, or local public office or office in a political organization," including the election of Presidential or Vice Presidential electors.[48]

While exempt from taxation for most Code purposes, political organizations are taxed, at the highest applicable corporate rate (34 percent for taxable years beginning after December 31, 1987), on political organization taxable income. Such income generally consists of gross income for the year, other than exempt function income, minus the deductions directly connected with the production of such gross income.[49] Exempt function income, which is not subject to tax, is income from sources such as contributions, membership dues, and political fundraising that is segregated for use in exempt functions (i.e., political activity).[50]

Thus, for example, assume that in 1987 a political organization receives $100,000 in political contributions and membership dues that it keeps segregated for appropriate political use. In addition, the organization earns $20,000 in interest income (e.g., from depositing the political contributions in an interest-bearing checking account). The organization's political organization taxable income includes its interest income, but not the political contributions received, and accordingly equals $20,000.

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[48] Section 527(e)(2).

[49] Section 527(c).

[50] Section 527(c)(3). Exempt function income can include proceeds from a political fundraising or entertainment event, sales of political campaign materials, or conducting a bingo game, if not received in the ordinary course of any trade or business.

II. DEFINITION OF POLITICAL ACTIVITY

In general, a section 501(c) organization is engaged in political activity if it participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office.[51] The main issues involved in interpreting this rule are determining (1) who is a candidate in a political campaign, (2) what constitutes intervention in a campaign, and (3) when such intervention is attributed to a particular organization.

Candidates in political campaigns

In general, a candidate is "an individual who offers himself, or is proposed by others, as a candidate for an elective public office."[52] The office involved can be national, state, or local.[53] In order to meet this definition, however, it is not required that the election be contested or involve the participation of political parties.[54]

Clear standards do not exist for determining precisely at what point an individual becomes a candidate for purposes of the rule. On the one hand, once an individual declares his candidacy for a particular office, his status as a candidate is clear. On the other hand, the fact that an individual is a prominent political figure does not automatically make him a candidate, even if there is speculation regarding his possible future candidacy for particular offices.

Two recent lawsuits that currently are pending also concern allegations of political activity by section 501(c)(3) organizations.[55] In both cases, the Federal Government, as defendant, is accused of not enforcing the ban on political activity by section 501(c)(3) organizations.

Intervention in a political campaign

The determination of what constitutes intervention in a political campaign requires weighing all relevant facts and circumstances.[56] Section 501(c)(3) mentions "the publishing or distributing of statements" that support or oppose a candidate as an example of intervention. Other clear examples would include making or soliciting campaign contributions, providing publicity or volunteer assistance, and paying expenses of a political campaign.

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[51] Section 501(c)(3); Treas. Reg. sec. 1.501(c)(3)-1(c)(3)(iii).
[52] Treas. Reg. sec. 1.501(c)(3)-1(c)(3)(iii).
[53] *Id.*
[54] Revenue Ruling 67-71, 1967-1 C.B. 125.
[55] *Keane* v. *Baker*, No. 86-0588E (W.D.N.Y.), June 19, 1986 (alleging that a section 501(c)(3) organization was assisting the plaintiff's opponent in a political campaign); *Abortion Rights Mobilization, Inc.* v. *Baker*, No. 86-6092 (pending in the Second Circuit, and concerning whether the Catholic Church has engaged in political activity by opposing candidates who support the allowability of abortion).
[56] *See, e.g.*, Revenue Ruling 78-248, 1978-1 C.B. 154.

Endorsing a candidate for public office constitutes intervention in a political campaign.[57] In this respect, it does not matter that an organization's endorsement is asserted to have been based on neutral assessments of candidates' professional, intellectual, or ethical qualifications, rather than on partisan grounds.[58] Opposing a candidate also constitutes intervention, even if the organization does not endorse the candidate's opponents.[59]

In many cases, the critical issue in determining whether an activity constitutes intervention in a political campaign is whether it reflects or advances a preference as between competing candidates. Neutral efforts to educate voters are not treated as intervention, but an effort that is neutral on its face may in fact be biased, and accordingly constitute political activity.

In a 1978 revenue ruling, the Internal Revenue Service gave several examples illustrating the distinction between neutral voter education and political activity.[60] In one example, an organization published compilations of the voting records of all Members of Congress on major legislative issues involving a wide range of subjects. The publications contained no editorial opinion, and did not imply any viewpoint regarding particular Members or issues. The publication was held not to be a political activity. Similarly, an organization that, during a political campaign, published statements of positions on a wide range of issues by all of the candidates was held not to be intervening.

However, an organization that circulated responses by candidates to a questionnaire was held to be intervening in a campaign where the questions evidenced a bias on particular issues. An organization that publicized candidates' viewpoints only on a narrow range of issues also was held to be intervening.[61]

A special rule defining political activity applies to private foundations with regard to the application of the regulatory excise tax under section 4945. Involvement by a private foundation in voter registration activities is not considered political activity, for section 4945 purposes, if, among other requirements, the activities are nonpartisan, not confined to one specific election period, carried on in 5 or more states, and supported by broad-based donor contributions.[62]

Attribution of political activities to an organization

Where members of an organization are involved in political activities, it is necessary to determine whether such activities are attributable to the organization, or instead are undertaken independently by the individuals in their private capacities. In general, principles of agency are relevant to this determination. For example, acts undertaken by individuals under actual or purported au-

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[57] *See, e.g.*, G.C.M. 39941 (November 7, 1985).

[58] *See* G.C.M. 39941, *supra* (organization that rated judgeship candidates as "Approved," "Not Approved," or "Approved as Highly Qualified" was intervening in political campaigns even though ratings were given on a nonpartisan basis); Revenue Ruling 76-456, 1976-2 C.B. 151 (organization that asked candidates to sign a code of fair campaign practices, and released the names of candidates who signed and refused to sign, was intervening in political campaigns).

[59] *See, e.g., Christian Echoes National Ministry, supra.*

[60] Revenue Ruling 78-248, 1978-1 C.B. 154.

[61] *Id.*

[62] Section 4945(f).

thority to act for the organization, and acts planned or ratified by the organization are considered activities of the organization.[63] Where an exempt organization uses a business subsidiary as a "guise" for carrying out particular activities without restriction, the subsidiary's activities are attributed to the parent.[64]

[63] *See* G.C.M. 34631 (October 4, 1971).
[64] *See* G.C.M. 33912 (August 15, 1968).

III. DEFINITION OF LOBBYING ACTIVITY

In general, a section 501(c) organization is engaged in lobbying activity if it advocates the adoption or rejection of legislation. For this purpose, the term "legislation" includes action by Congress or any State or local legislative body, or by the public in a referendum, initiative, constitutional amendment, or similar procedure.[65] It makes no difference whether the legislation is beneficial to the community.[66] The main issues involved in determining what constitutes lobbying are determining (1) what is an attempt to influence legislation, or an allowable exception to the definition, and (2) when a lobbying activity is treated as the activity of a particular organization.

Attempting to influence legislation

Lobbying includes such activities as (1) directly contacting members of a legislative body (or their staffs) to propose, support, or oppose legislation,[67] (2) grass roots lobbying (urging the public to contact legislators or legislative staffs to propose, support, or oppose legislation), and (3) more generally, advocating the adoption or rejection of legislation.

There are a number of circumstances, however, in which commenting on proposed legislation is not treated as lobbying. For section 501(c)(3) purposes, when an organization not otherwise involved in taking a position with regard to legislation engages in nonpartisan analysis thereof, and communicates its analysis to legislators, the organization nonetheless is not engaged in lobbying if it takes no position (e.g., it merely gathers relevant materials and data not calculated to support a particular position).[68]

A somewhat different rule may apply under section 4945 (the regulatory excise tax for political activities by private foundations). For purposes of this provision, nonpartisan analysis may express a particular viewpoint, without constituting lobbying, "as long as there is a sufficiently full and fair exposition of the pertinent facts to enable the public or an individual to form an independent opinion or conclusion."[69]

Under the various relevant Code provisions, an organization is not engaged in lobbying if, in response to a formal request for assistance by a legislative body, it provides technical advice or assistance.[70] Moreover, for purposes of section 4911 (relating to lobbying

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[65] Treas. Reg. sec. 1.501(c)(3)-1(c)(3)(ii).

[66] *See, e.g.*, Revenue Ruling 67-293, 1967-2 C.B. 185.

[67] Requesting an executive body to support or oppose legislation also constitutes lobbying. *See, e.g.*, Revenue Ruling 67-293, 1967-2 C.B. 185.

[68] *See, e.g.*, Revenue Ruling 64-195, 1964-2 C.B. 138.

[69] Treas. Reg. sec. 53.4945-2(d)(1)(ii).

[70] Section 4911(d)(2)(B); section 4945(e)(2). *See also* Revenue Ruling 70-449, 1970-2 C.B. 111 (interpreting the general rule for organizations described by section 501(c)(3)).

activities by a section 501(c)(3) organization that elects the application of section 501(h)), an organization is not treated as lobbying if it communicates with its *bona fide* members regarding issues of direct interest to the organization and such members, so long as the communications do not directly encourage such individuals to engage in lobbying.[71]

For purposes of section 4945 (the regulatory excise tax on private foundations), lobbying does not include discussions of broad social, economic, and similar problems, even when such discussions are communicated to legislators who are considering legislation relating to such broad problems. However, this exception does not apply unless the discussion does not specifically address the proposed legislation.[72]

Further, lobbying may not include certain activities that are directly in the self-interest of the exempt organization itself. For example, "self-defense" is not lobbying, at least for purposes of sections 4911 and 4945. For this purpose, "self-defense" means appearing before, or communicating with, a legislature regarding legislation that might affect the organization's existence, powers and duties, tax-exempt status, or the deduction of contributions to the organization.[73] Moreover, lobbying may not include soliciting government funds for the organization's programs.[74]

Treating a lobbying activity as the activity of a particular organization

With lobbying activities, as with political activities, issues may arise regarding whether the activity of a particular member are attributable to the organization. Similar attribution principles apply in the two contexts.

For lobbying purposes, an additional issue of responsibility for particular activities arises. This issue relates to the rules of section 4911 that provide dollar limitations on the amount that a section 501(c)(3) organization can spend on lobbying if it elects the application of section 501(h).

In order to prevent organizations from avoiding these dollar limitations by dividing themselves into technically separate but related entities, section 4911(f) provides affiliation rules. Under these rules, related organizations each of which has elected the application of section 501(h) may be treated as a single organization, for section 4911 purposes.

In general, affiliation is found where organizations are subject to common control. For example, if one organization is required by its governing instrument to be bound by decisions of another organization, then the two organizations are treated as affiliated.[75] Affiliation likewise is found where the governing board of one organization is controlled, for practical purposes, by designated representatives, board members, officers, or paid executive staff members of a second organization.[76] Rules also apply to aggregate lobbying ex-

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[71] Section 4911(d)(2)(d).
[72] Treas. Reg. sec. 53.4945-2(d)(4).
[73] Section 4911(d)(2)(C); section 4945(e).
[74] Treas. Reg. sec. 53.4945-2(a)(3); *Slee* v. *Commissioner*, 42 F.2d 184 (2d Cir. 1930).
[75] Section 4911(f)(2)(A).
[76] Section 4911(f)(2)(B).

penditures by different organizations where there is limited affiliation; i.e., one organization controls another solely with regard to national legislation.[77]

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[77] Section 4911(f)(4).

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